Regional Outlook

FEDERAL DEPOSIT INSURANCE CORPORATION THIRD QUARTER 2001

FDIC
BOSTON
REGION

DIVISION OF
INSURANCE

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A Message to Our Readers

The FDIC community extends its deepest sympathy to the families, friends, and co-workers of the victims of the attacks on September 11, 2001.

The articles in this edition of the *Regional Outlook* were prepared before the tragic events of September 11. We will assess the implications of these events in future issues of the *Regional Outlook*. The public can rest assured that deposit insurance is in full force—money is safe in an FDIC-insured account.

Regional Perspectives

◆ ***Regional Economic Conditions*—New England's economic growth slowed through midyear 2001. As the Region lagged the nation going into the present slump, it may also lag the nation in a return to stronger economic growth if, as widely expected, the recovery in the information technology sector trails that for overall manufacturing.** *See page 3.*

◆ ***Focus on Fraud Risk Management*—Employee fraud poses a significant risk to insured institutions, particularly during economic downturns. Effective risk management measures and fidelity insurance reduce the possibility of fraud loss at insured institutions. In light of deteriorating economic conditions, fidelity insurance coverage levels among insured institutions may be worthy of review.** *See page 6.*

By the Boston Region Staff

In Focus This Quarter

◆ ***Slowing Economy Reduces Demand for U.S. Office Space*—A slowing economy has contributed to softening in many U.S. office markets during the first half of 2001. The office vacancy rate has recorded the largest six-month increase in the past 20 years. A combination of trends—a substantial drop in demand for office space and an uptick in construction activity in some markets—has led to this slackening.**

This article reviews recent developments in U.S. office markets and describes demand-side and supply-side trends that have contributed to the recent weakness. It notes the role played by the changing fortunes of high-tech firms in a number of U.S. metro areas and how this situation has contributed to large increases in the volume of space available for sublease. Finally, the article focuses on the local construction and commercial real estate loan exposures of FDIC-insured banks and thrifts that have the task of managing their risks under changing market conditions. *See page 11.*

By Thomas A. Murray

The ***Regional Outlook*** is published quarterly by the Division of Insurance of the Federal Deposit Insurance Corporation as an information source on banking and economic issues for insured financial institutions and financial institution regulators. It is produced for the following eight geographic regions:

Atlanta Region (AL, FL, GA, NC, SC, VA, WV)
Boston Region (CT, MA, ME, NH, RI, VT)
Chicago Region (IL, IN, MI, OH, WI)
Dallas Region (CO, NM, OK, TX)
Kansas City Region (IA, KS, MN, MO, ND, NE, SD)
Memphis Region (AR, KY, LA, MS, TN)
New York Region (DC, DE, MD, NJ, NY, PA, PR, VI)
San Francisco Region (AK, AS, AZ, CA, FM, GU, HI, ID, MT, NV, OR, UT, WA, WY)

The ***Regional Outlook*** is available on-line by visiting the FDIC's website at www.fdic.gov. For more information or to provide comments or suggestions about the Boston Region's ***Regional Outlook,*** please call Daniel Frye at (781) 794-5678 or send an e-mail to *dfrye@fdic.gov.*

Regional Perspectives

- **Economic growth slowed in the Region through midyear 2001.**
- **Employee fraud poses a significant risk to insured institutions, particularly during economic downturns.**
- **Fidelity insurance coverage levels among insured institutions may be worthy of review in light of deteriorating economic conditions.**

Regional Economic Conditions

Region Followed Nation into Economic Slump

Between December 2000 and mid-2001, preliminary economic statistics and anecdotal evidence, such as that collected for the ***Federal Reserve's*** periodic Beige Book report, began to confirm that the Region's growth had decelerated sharply this year; although in some respects, such as job growth, the Region seemed to be doing better than other parts of the country.

By midyear, the nature of the current economic malaise had expanded from simply a recession in certain old-line manufacturing industries and the despoiling of the dot-coms to embrace (to varying degrees) other industries that are more significant employers in the Region, such as information technology (IT) manufacturing, retail trade, and financial services. Worse yet, the two factors that contributed mightily to the Region's above-average economic performance in recent years—the strong equity market and booming demand for IT products and services—were both in a slump as of June, with little expectation of improvement before year-end.

As of June, nonfarm employment in the Region was up 1.5 percent from year-ago levels. Although this growth was stronger than the nation's (0.8 percent), it reflected a sizable deceleration from the prior year's pace. The year-over-year drop in manufacturing employment in the Region was also not as pronounced as that seen nationally—this also appeared to be the case for IT manufacturing. Recent difficulty in filling job openings may help explain the Region's more favorable employment performance relative to the nation. On net, employers may be reluctant to resort to mass layoffs as a cost-cutting measure, given their significant efforts to find qualified workers in recent years. This situation could worsen if corporate profits and economic growth do not show some strength in the next several months.

In addition to slower job growth, rising unemployment and an increase in personal bankruptcy filings were features of the slowing economy by midyear. The Region's seasonally adjusted unemployment rate was 3.2 percent in June, up from its recent low of 2.4 percent in December and January. Unemployment rates were higher in all the Region's states through the first half of 2001, with the worst deterioration in **Massachusetts** and **Rhode Island** (see Table 1). Meanwhile, **Connecticut** continued to post the Region's (and one of the nation's) lowest unemployment rates in June.

Along with higher unemployment rates, initial unemployment claims between January and June significantly exceeded year-earlier levels (see Chart 1, next page). During the first six months of the year, average claims in the Region were up 25 percent from the same months in 2000, while nationally the increase was 32 percent. If the trend holds for the entire year, it will mark the

Table 1

Rising Unemployment Rates Highlight Region's Economic Slump
(seasonally adjusted unemployment rates)

	Jun-01	Dec-00	Change
United States	4.5	4.0	0.5
New England	3.2	2.4	0.8
Connecticut	2.5	2.0	0.5
Maine	3.3	2.7	0.6
Massachusetts	3.4	2.3	1.1
New Hampshire	3.0	2.3	0.7
Rhode Island	4.7	3.6	1.1
Vermont	3.0	2.7	0.3

Source: Bureau of Labor Statistics

Region's heftiest annual percentage increase in claims since 1990.

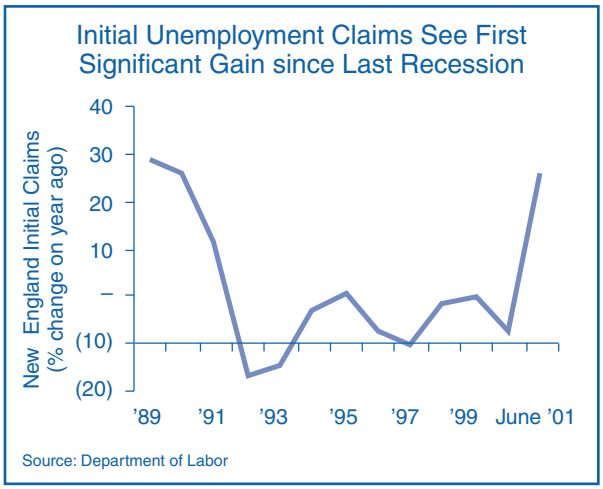
Another possible sign of the economy's weakness was found in personal bankruptcy filings, which rose at an annual rate of 12 percent during the first quarter, after falling during the prior two years. However, the Region's first quarter increase was not as pronounced as the gain seen nationally, while per capita filing rates in the Region remained well below the national average. Also, some of the first quarter increase may have been due to debtors' attempts to file ahead of federal bankruptcy reform legislation. Business bankruptcies across the Region continued their four-year declining trend during the first quarter, although at a reduced pace from prior years.

Consumer Spending Keeps Economic Growth above Water

As of June, continued strength in consumer spending was anticipated to be critical for both the nation's and the Region's economic course, particularly given that the other prominent source of economic growth during the past several years, business investment in capital equipment, had slumped significantly in recent quarters. The Region's economy, especially in eastern Massachusetts and southwestern Connecticut, benefited handsomely from stellar gains in the equity market through early 2000.[1] With the ongoing (as of this writing) protracted weakness in equity markets, the potential existed for an even more pronounced pullback in IT and financial services employment and earnings, business investment, and consumer spending. A recent study suggested that, nationally, households in the top 20 percent of income (which benefited most from gains in stock market wealth during the late 1990s) accounted for most of the growth in consumer spending in recent years.[2] It is likely that this relationship holds true in the Region, given its preponderance of high-income households with sizable equity investment portfolios and compensation tied to stock options and equity-linked bonuses.

With the fate of the economy traveling hand-in-hand with consumers' proclivity to spend, the strength of the retail sector was a concern throughout the year. A review of ***Federal Reserve Beige Books*** released between January and June 2001 highlights the evolving nature of the economic slowdown. For example, retail contacts who started the year with growing sales (albeit "at rates slower than last year") and expectations of "a slowdown in economic growth during 2001, but not a recession," had changed their tune by June. As of the June report, most contacts in the industry reported sales only even with or below year-earlier levels, with some unplanned accumulation of inventories and eroding profit margins. Also, at that time they no longer believed the economy would pick up during the second half of 2001. In fact, most expected "flat to negative economic growth through the remainder of the year."[3] To be fair, retail sales nationally (no official local statistics are published) showed some renewed strength in the second quarter, after year-ago growth bottomed out in February. Also, although the Region's average consumer confidence reading between January and June was lower than its average during the prior three years, it still corresponded to levels that typically coexist with solid consumer spending. Furthermore, even at its lowest point in April, consumer confidence in the Region was twice as high as the low experienced during the early 1990s recession. The Region's strength in homeowners' equity, suggested by several years of strong home-price appreciation, likely has offset some of the drag on consumer spending resulting from the significant loss in stock market wealth since early 2000.

Chart 1



[1] For more information on this topic, see Stock Market Gains Have Benefited New England, but May Also Pose a Risk, *Boston Regional Outlook*, third quarter 2000.

[2] Maki, Dean M., and Michael G. Palumbo. April 2001. *Disentangling the Wealth Effect: A Cohort Analysis of Household Saving in the 1990s.* Board of Governors of the Federal Reserve System.

[3] Federal Reserve Board. January 17 and June 13, 2001. *The Beige Book.* First District-Boston.

Despite a continuation of strong appreciation in home prices, existing home sales were flat to down slightly during first quarter 2001 (albeit from historically high levels), and this trend likely persisted through the peak buying season. Meanwhile, residential construction activity sounded a decidedly negative tone. In the Region, permit issuance through May was off 6 percent from year-ago levels, versus a 4 percent gain nationally. New permit volume has been decreasing since 1998 in the Region, and much of the weakness has been centered in southern New England. Even so, all the Region's states witnessed declining permit volume between January and May 2001.[4]

[4] 1995 was the last year that all six states posted a contemporaneous drop in permit issuance.

Focus on Fraud Risk Management

The Nature of Fraud

Fraudulent activity poses an ongoing and significant risk to financial institutions, and while fraud manifests itself in many forms, the vast majority of fraud is carried out by a firm's own employees. ***Ernst & Young's*** (E&Y) 2000 ***International Fraud Survey*** found that over 80 percent of the most sizable losses from fraud were internal, and one-third these internal frauds were carried out by individuals in managerial positions. E&Y also found that nearly half of the employees who perpetrated frauds had been with their firms for more than five years. This finding suggests that the greatest risk of loss to an organization from internal fraud rests with its most trusted employees. The 1996 ***Association of Certified Fraud Examiners'*** (ACFE) ***Report to the Nation*** disclosed that losses caused by managers and executives were 16 times greater than those caused by nonmanagerial employees. The higher losses were attributed to the greater degree of financial control exercised by individuals in managerial positions.

To understand why internal abuse occurs, it helps to examine the nature of fraud. The ***Institute of Management and Administration's*** (IOMA) ***Report on Preventing Business Fraud*** identifies two types of fraud risk factors: individual and generic. Individual factors, which include greed and need, relate to an individual's general character and personal circumstances. In some instances, the motivation may be revenge for being passed over for a particular job or assignment. These individual factors can become more important during economic downturns or recessions, when employees may attempt to supplement their income to offset hardships arising from high debt levels, lower compensation, or the job loss of a spouse, for example. Individual factors are largely beyond the control of management, although effective employee monitoring and appraisal practices can provide an early warning of potential problems.

Generic factors include perceived opportunity to commit fraud, the probability of discovery, and the severity of punishment if discovered. Generic factors are largely within the control of management, and several steps can be taken to limit opportunities to commit fraud and increase chances of early detection. Although every employee's personal circumstances are different, effective management of these generic factors will minimize the motivation to commit fraud.

Respondents to a 1998 E&Y *International Fraud Survey* ranked normal internal routines and controls and internal audit as the two most effective ways of both preventing and detecting fraud. The following action steps have been effective in managing a company's overall exposure to employee fraud.[5] While not listed in order of importance, these steps clearly emphasize creating an environment of deterrence.

- Establish a corporate code of conduct.
- Provide periodic ethics training for all employees.
- Provide training in fraud detection and prevention.
- Increase the role of the audit committee in fraud management.
- Conduct thorough preemployment screening.

[5] Ernst & Young, KPMG. *Fraud Risk and Prevention Business Guide* and Corporate Executive Board Counsel Roundtable. 2000. *Corporate Anti-Fraud Programs Issue Brief*.

- Review and improve internal controls.
- Conduct a fraud audit.
- Establish an employee fraud reporting hotline.
- Develop a contingency plan for managing a fraud event.

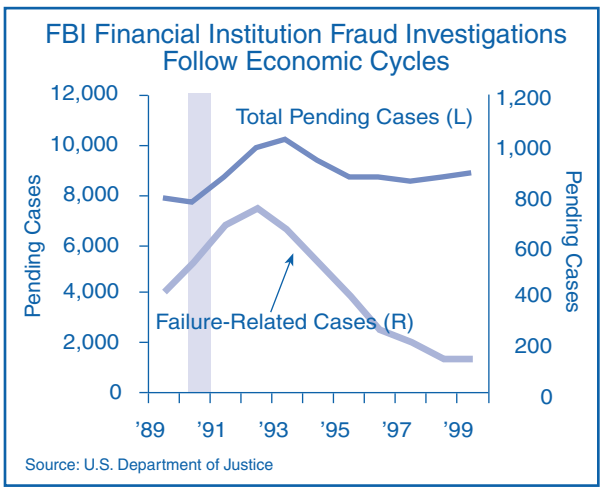
Employee Fraud Is a Significant Threat to Financial Institutions

It is the fiduciary responsibility of the board of directors to ensure that effective measures are in place to protect a firm's assets and minimize potential losses arising from internal fraud. This protection is particularly important to the financial health of banks and thrifts. In the 1996 ACFE report noted above, the median loss rates per employee fraud occurrence for financial institutions were among the highest of the 12 industry sectors examined, with thrift loss rates the highest at $475,000. This finding underscores the importance of effective controls, particularly where the very foundation of a financial institution's existence is built upon its customers' trust and belief that their assets are being properly safeguarded.

In cases of excessive loss, fraud does lead to failure. Several studies of the reasons for bank failures in the 1980s and early 1990s suggest that insider fraud was a significant contributing factor to the failure of anywhere from 11 percent to 33 percent of failed institutions.[6] This fact is particularly significant when one considers that nearly 3,000 banks and thrifts have failed in the past 20 years.

Although the total number of bank failures has declined markedly since 1992, several failures in recent years have been attributed largely to apparent internal fraud, most notably the First National Bank of Keystone in Keystone, West Virginia, and Best Bank of Boulder, Colorado. FBI statistics also reveal that even though fraud investigations related to failed financial institutions have fallen significantly as the number of failures has diminished, overall investigations into financial institution fraud have not fallen appreciably and in fact rose slightly in 1999, the last year for which data are available (see Chart 2). While the percentage of pending investigations related to insider fraud is not available, insiders have generally represented approximately 30 percent of all convictions. Thus, even in good economic times, internal fraud can threaten the viability of a financial institution.

Chart 2



Economic Slowdown May Spur an Increase in Fraud Activity

The patterns of the past suggest that evidence of fraud increases following a downturn in general economic conditions, which reveals situations that are masked during good economic times. In addition, as discussed previously, deteriorating conditions may create an environment that breeds new fraudulent activity. The June 2001 ***SAR Activity Review,*** published under the auspices of the ***Bank Secrecy Act Advisory Group,*** provides statistical data on suspicious activity reports (SARs) filed by financial institutions and may indicate that employee fraud is indeed surfacing as the economy softens. The report shows that filings related to crimes of an internal nature—including bribery, embezzlement, misuse of position, and mysterious disappearance—rose 16 percent in 2000 after remaining fairly stable in the prior three years.

If All Else Fails, Fidelity Insurance Is Essential

The potential for internal fraud can be minimized but not entirely erased. It is not practical for an institution to attempt to eliminate fraud completely, as internal

[6] Federal Deposit Insurance Corporation. *History of the Eighties—Lessons for the Future, Vol. I: An Examination of the Banking Crises of the 1980s and Early 1990s*, p. 34. 1997. Washington, DC.

policies and controls that place too many restrictions on employees may not be cost-effective and may affect employee morale negatively, impairing productivity and reducing the quality of customer service. As fraud represents a source of significant or even catastrophic loss to any institution, residual risk should be shifted to other parties through appropriate levels of fidelity insurance coverage.

Fidelity coverage is typically provided for under Clause A of the Financial Institution Bond (FIB). The FIB also provides financial institutions with a broad range of coverage for losses arising from external sources such as robbery, forgery, and the acceptance of counterfeit currency. For most institutions, potential losses arising from internal fraud represent the greatest source of catastrophic loss. Thus, many institutions also maintain an excess employee dishonesty bond (EEDB) that provides supplemental insurance for fidelity-related losses. The following discussion provides an overview of trends in fidelity coverage for insured institutions. The data are derived from FDIC and state examination reports and are believed to be representative of the overall banking industry.

Determining an appropriate level of fidelity insurance to protect against losses resulting from employee dishonesty is difficult. Trade groups and the insurance industry offer various schedules of recommended or median coverage ranges based on deposit or asset size. However, the level of risk in any institution is influenced by several other factors, such as the amount of cash and securities on hand, the number of employees and their experience level, delegations of authority to employees, the extent of off-balance-sheet activities, and whether an institution is growing rapidly. In addition to the various risk factors, coverage should be measured against an institution's economic and competitive environment and its ability to absorb unforeseen losses through current earnings, tax-loss carrybacks, and capital.

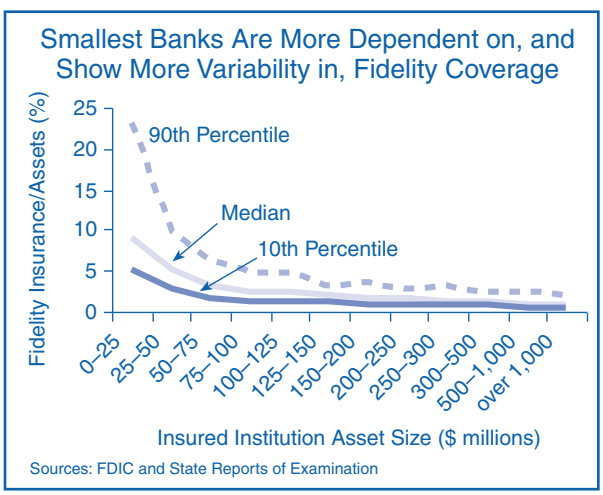
Fidelity Coverage Is Particularly Important for Small Institutions

The aforementioned ACFE *Report to the Nation* noted that small organizations (fewer than 100 employees) were the most vulnerable to insider fraud. Median losses per incident in small firms approximated those in the very largest firms; however, the losses represented a far greater percentage of the smaller firms' assets. Smaller firms typically do not have the resources to create the level of sophisticated internal controls and internal audit functions that a larger company can achieve. Consequently, smaller firms are much more susceptible to catastrophic losses that can threaten their solvency (and insurance takes on greater importance as a means to protect against such losses).

Fidelity insurance is an integral part of an overall risk management program for all financial institutions, but it is especially important in small institutions, particularly those with under $100 million in total assets. Chart 3 displays certain percentiles of total fidelity insurance coverage to total assets for institutions of various asset size groups. The data are based on state and FDIC bank examinations conducted during 2000. Not surprisingly, small institutions rely much more on fidelity insurance coverage than do large firms. For small institutions, fidelity insurance is a vehicle for capital preservation, whereas for large firms, it is more of a means to protect current earnings.

It is also noteworthy that there is significant variance in coverage levels for smaller institutions. Smaller institutions with lower coverage levels may be placing a far greater percentage of capital at risk than institutions with median coverage levels, particularly if they also maintain a relatively low leverage ratio. Of the 3,300 examination reports reviewed for the 2000 exam cycle, approximately 7 percent of the institutions were in the lowest quartile of their respective asset size group for both fidelity coverage to assets and Tier 1 capital to assets. Smaller institutions fitting this profile are far less capable of absorbing a substantial unanticipated loss than their better-capitalized or better-insured peers.

Chart 3



Fidelity Coverage Remains Flat despite History of the Eighties and Nineties

Table 2 sets forth historical data on fidelity bond coverage for institutions of various sizes. As the table indicates, the median level of fidelity coverage has remained fairly constant across all asset sizes since the late 1980s, although institutions with less than $250 million in total assets have actually registered a slight decline in coverage when measured against total assets. This decline is somewhat surprising, given the fact that a significant percentage of bank failures have been attributed directly to insider fraud and abuse. Additionally, the fidelity bond industry has been highly competitive since the mid-1990s, and premiums have fallen considerably since then. These lower premiums have not translated into higher fidelity coverage levels.

While there has been a noticeable rise in FIB levels, aggregate fidelity coverage has remained fairly flat. The increased coverage provided by Clause A has been largely offset by elimination of coverage under excess employee dishonesty bonds. Chart 4 depicts this trend for small institutions, where the shift has been most prevalent, although the shift has been significant for all institutions with under $500 million of total assets. In the late 1980s, nearly 80 percent of all institutions in the examination database had an excess policy. That percentage fell to less than 30 percent in 2000. This shift of coverage solely into the FIB has had the beneficial

Table 2

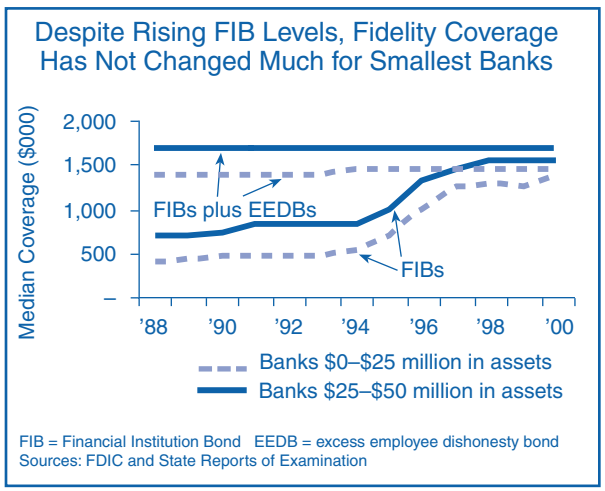
Total Fidelity Insurance Coverage by Asset Size

Insured Institution Asset Size ($ Millions)	Median Total Fidelity Insurance												
	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
($000)													
$0-$25	1,375	1,375	1,375	1,375	1,375	1,375	1,450	1,450	1,450	1,450	1,450	1,450	1,450
$25-$50	1,675	1,675	1,675	1,675	1,675	1,675	1,675	1,675	1,675	1,675	1,675	1,675	1,675
$50-$75	2,050	2,050	2,000	2,050	2,050	2,050	2,050	2,050	2,050	2,000	1,963	2,000	2,000
$75-$100	2,275	2,275	2,050	2,050	2,050	2,050	2,050	2,050	2,050	2,050	2,050	2,050	2,050
$100-$125	2,775	2,285	2,288	2,275	2,275	2,275	2,275	2,500	2,300	2,500	2,275	2,275	2,275
$125-$150	2,800	2,800	2,300	2,800	2,800	2,800	2,800	2,800	2,800	2,800	2,800	2,800	2,800
$150-$200	3,000	2,800	2,800	3,000	2,800	3,000	2,800	2,800	2,800	2,800	2,800	2,800	2,800
$200-$250	3,500	3,500	3,000	3,000	3,000	3,500	3,500	3,500	3,275	3,500	3,500	3,000	3,500
$250-$300	3,750	3,250	3,000	3,500	3,000	3,500	3,500	3,500	3,750	3,500	3,800	3,550	3,500
$300-$500	4,000	4,200	3,625	4,750	4,750	5,000	4,750	4,600	4,500	4,750	4,000	4,000	4,000
$500-$1,000	5,000	5,000	5,000	5,000	5,000	6,000	6,755	6,000	7,000	6,000	6,000	6,000	6,000
over $1,000	15,000	11,000	10,000	10,000	10,000	15,000	15,000	10,000	20,000	15,000	19,000	20,000	18,500
(% of Assets)													
$0-$25	9.26	9.28	8.91	8.77	8.61	8.54	8.42	8.82	8.65	8.62	8.83	8.82	8.80
$25-$50	4.94	4.85	4.83	4.74	4.76	4.72	4.76	4.77	4.78	4.80	4.83	4.74	4.90
$50-$75	3.29	3.24	3.17	3.17	3.20	3.15	3.17	3.26	3.22	3.20	3.12	3.30	3.21
$75-$100	2.58	2.59	2.52	2.52	2.50	2.50	2.50	2.52	2.52	2.53	2.54	2.44	2.46
$100-$125	2.28	2.22	2.24	2.20	2.24	2.20	2.23	2.25	2.24	2.27	2.11	2.03	2.16
$125-$150	2.10	2.00	1.72	1.94	1.98	1.96	1.97	2.04	1.97	2.04	2.09	1.99	1.93
$150-$200	1.87	1.75	1.65	1.79	1.74	1.82	1.70	1.75	1.70	1.65	1.73	1.65	1.66
$200-$250	1.52	1.49	1.27	1.30	1.35	1.47	1.52	1.48	1.42	1.48	1.49	1.44	1.44
$250-$300	1.26	1.27	1.10	1.20	1.17	1.22	1.19	1.35	1.41	1.32	1.48	1.33	1.29
$300-$500	1.09	1.23	0.96	1.21	1.20	1.26	1.18	1.18	1.11	1.18	1.07	1.10	1.07
$500-$1,000	0.80	0.85	0.79	0.83	0.81	0.94	1.02	0.94	1.06	0.95	0.91	0.91	0.89
over $1,000	0.59	0.50	0.52	0.56	0.58	0.79	0.65	0.51	0.70	0.80	0.79	0.79	0.75

Total Coverage = Financial Institution Bond + excess employee dishonesty bond

Sources: FDIC and State Reports of Examination

CHART 4



effect of raising the level of protection for losses covered by other clauses within the FIB. However, institutions have been reluctant to increase aggregate fidelity coverage levels over the past few years, even though the vast majority of significant fraud losses are internal.

Despite the greater protection from many threats that has resulted from rising FIB levels, the concentration of *fidelity* coverage into the FIB may result in diminished fidelity coverage in certain circumstances. All claims paid during the term of the FIB are applied to the aggregate bond limit, and once that is reached, the bond is automatically cancelled. Therefore, losses covered by other clauses in the FIB can erode fidelity coverage over the term of the bond. This fact is worthy of consideration, especially during periods of economic weakness, because losses arising from external sources may become more prevalent as the economy slows, effectively reducing the fidelity protection afforded by Clause A.

Fidelity Coverage Ratios at Savings Institutions Are Lower than at Commercial Banks

The schedule of median coverage ratios set forth in Table 2 are for all banks and thrifts examined by the FDIC or state regulatory agencies. Savings banks typically carry lower levels of fidelity coverage than do their commercial counterparts. During the mid-1990s, median coverage levels for savings banks approximated 55 percent of the level maintained by commercial banks. The percentage has gradually risen over the past few years and now approximates two-thirds that of commercial banks. Rising coverage at savings banks is a favorable trend that is particularly relevant to the Boston Region, where savings banks are 70 percent of all insured institutions. The rise suggests that many savings institutions are reassessing existing fidelity coverage and are opting for greater levels of protection in light of the many structural and technological changes that have transpired over the past few years.

Data obtained from the ***Surety Association of America*** indicate that direct losses on financial institution bonds for commercial banks for 1988 through 1999 were less than those of savings institutions when measured against the average assets of each industry over that time frame. Additionally, the ACFE *Report to the Nation* reported that the median loss per incident in the real estate financing industry, which included savings institutions, was the highest of all industries listed and was over twice that reported for the commercial banking industry. These data suggest that the risk of fraud and abuse in savings institutions, from a fidelity perspective, is not significantly different from that of commercial organizations. Many savings institutions in the Region are beginning to expand into commercial banking activities, and anecdotal evidence suggests that insurers do not differentiate underwriting criteria based on charter type.

The Best Offense Is a Good Defense

Bank and thrift managers should be aware that a slowing economy may lead to an increase in the number and severity of fraudulent acts by employees. Nearly 90 percent of the respondents to the E&Y 2000 fraud survey believe that "the incidence of fraud in the last five years has stayed the same or increased, and that it will stay the same or increase over the next five years." Effective fraud deterrence policies, audit programs, and strong internal controls are the first lines of defense for minimizing exposure to and detecting fraud. As earnings soften, many institutions undertake cost-cutting campaigns to enhance profits. Care should be taken to ensure that these efforts do not undermine existing control mechanisms. As a secondary measure, fidelity insurance can play a critical role in preserving the solvency of an insured institution that is victimized by a significant fraud event. Ensuring that all these aspects of an effective fraud risk management program are in place is an important function of the board of directors and senior management, and it becomes particularly important in a period of economic uncertainty.

By the Boston Region Staff

Slowing Economy Reduces Demand for U.S. Office Space

- **Demand for U.S. office space contracted during the first half of this year as the amount of newly vacated space exceeded the amount of newly occupied space for the first time since at least 1981.**

- **The U.S. office vacancy rate jumped 250 basis points in the first half of 2001, from 8.3 percent to 10.8 percent.**

- **With construction levels remaining high and demand still weak, the vacancy rate could rise further by year-end.**

Overview

Commercial real estate (CRE) markets traditionally have been—and remain—highly cyclical. During the 1990s, most U.S. office markets experienced a strong upswing. However, declining office employment growth along with other recent signs point to a possible downturn. As reported by ***Torto Wheaton Research*** (TWR), the U.S. office vacancy rate, which stood at a 19-year low of 8.3 percent at the end of 2000, jumped in only six months to 10.8 percent, the largest six-month increase in the 20 years TWR has tracked these data. Office vacancy increases range from modest levels in some markets to high levels in markets where supply and demand imbalances are more pronounced.

An uptick in construction activity combined with a substantial drop in demand for office space has led to a slackening of office market conditions. In light of the ongoing uncertainty as to the near-term direction of the U.S. economy, these trends make the current situation difficult for office market participants to read.

This article reviews recent developments in U.S. office markets and describes demand-side and supply-side trends that have contributed to the recent weakness.[1] It notes the role played by the changing fortunes of high-tech firms in a number of metropolitan areas and how this situation has increased the volume of space available for sublease. Finally, the article focuses on the local construction loan exposures of insured banks and thrifts that have the task of managing their risks under changing market conditions.

Vacancy Rates Have Risen Quickly from Cyclical Lows

At year-end 2000, the U.S. office vacancy rate stood at 8.3 percent—a 19-year low. Many individual metro areas posted even lower vacancy rates. For example, at year-end 2000, vacancies were 4.4 percent of available space in Seattle, 1.3 percent in San Jose, and 3.0 percent in Oakland. Beginning with first quarter 2001, as a result of a slowing economy and the fallout from the so-called "tech-wreck," the U.S. vacancy rate rose by 120 basis points to 9.5 percent—the highest absolute quarterly increase since these data were first published in 1981. Another record increase of 130 basis points occurred during the second quarter, bringing the vacancy rate to 10.8 percent. To put these increases in perspective, consider that the national office vacancy rate has increased more than 50 basis points in any given quarter only twice.[2] Nonetheless, the current vacancy rate of 10.8 percent remains low by historical standards, as the average rate for the past 20 years has been 13.9 percent.

Most of the nation's large metro areas saw increases in office vacancies during the first half of 2001. Forty-eight of the 53 major metropolitan areas tracked by TWR recorded a higher vacancy rate in June 2001 than at year-end 2000. Thirty-eight markets experienced increases of at least 100 basis points, and four markets saw vacancy rates jump by more than 600 basis points. As shown in Table 1 (next page), most of the markets experiencing the largest jump in vacancy rates also are home to concentrations of high-tech employment.[3] As

[1] For further discussion of demand and supply trends, see Sally Gordon, "CMBS: Red – Yellow – Green™ Update, Second Quarter 2001 Quarterly Assessment of U.S. Property Markets," *Moody's Investors Service,* July 6, 2001.

[2] TWR notes increases of 60 basis points in the second quarter of 1989 and in the first quarter of 1999.

[3] Seven of the ten markets with the highest first-half 2001 vacancy rate increases are also among the top ten cities having the greatest levels of high-tech employment.

Table 1

In Many Markets, Office Vacancy Rates Reflect Concentrations of High-Tech Employment

Metro Area	Vacancy Rate as of 6/30/01 (%)	Vacancy Rate as of 12/31/00 (%)	Increase in Vacancy Rate (basis points)	High-Tech as % of Total Market Employment
Austin	11.8	5.0	680	10.1
San Jose	8.1	1.3	680	27.4
Oakland	9.3	3.0	630	6.5
San Francisco	10.3	4.1	620	8.3
Seattle	9.4	4.4	500	6.6
Kansas City	15.9	11.0	490	2.7
Boston	8.7	3.9	480	8.2
Phoenix	16.9	12.5	440	4.7
Wilmington, DE	10.4	6.2	420	3.8
Washington, DC	7.8	3.9	390	7.8
Nation	10.8	8.3	250	4.8

Sources: Torto Wheaton Research, Economy.com, Inc.

high-tech markets spurred higher demand for office space in the recent past, these markets are now giving back greater quantities of previously occupied office space. Table 2 (see page 18) lists office vacancy rates and changes along with lending concentrations, construction activity levels, and high-tech employment percentages for 53 major metropolitan areas and for the nation.

Unlike the last cycle, during which office vacancies shot up primarily in overbuilt downtown areas, recent increases are occurring more sharply in suburban than downtown sections of metropolitan areas. As of June 30, 2001, the average downtown office vacancy rate was 8.5 percent, and the average for suburban markets was 12.1 percent. Increases in office availability are dispersed among Class A office properties as well as Class B/C properties, yet vacancy rates do show disparities across many submarkets. For example, the South of Market area in San Francisco reports significantly higher office vacancy rates than the Financial District.[4] Similarly, in the Washington, DC, metropolitan area, the technology-intensive northern Virginia office market has experienced higher office vacancy increases than downtown Washington, DC, or suburban Maryland.

[4] Louis, Arthur M. July 24, 2001. "Empty Offices, Economic Downturn, Overconstruction Leave Commercial Landlords with More Space on their Hands." *San Francisco Chronicle.*

Office Demand Drops

Net absorption, the primary indicator of demand for office space, was negative during first quarter 2001 for the first time since TWR began reporting the series.[5] (Negative absorption occurs when space returned to the market by existing tenants exceeds the space occupied by new tenants.) This negative performance was repeated in the second quarter. The decline in the volume of competitively leased space totaled 30 million square feet during the first half of 2001. (See Chart 1.)

The bulk of negative absorption in the first half of 2001 is due to the return of office space to the market through subleasing.[6] TWR reports that there were 43 million square feet of space "give-backs" through subleasing in the first half of 2001, and after offsetting absorption of 13 million square feet, negative absorption was 30 million square feet.

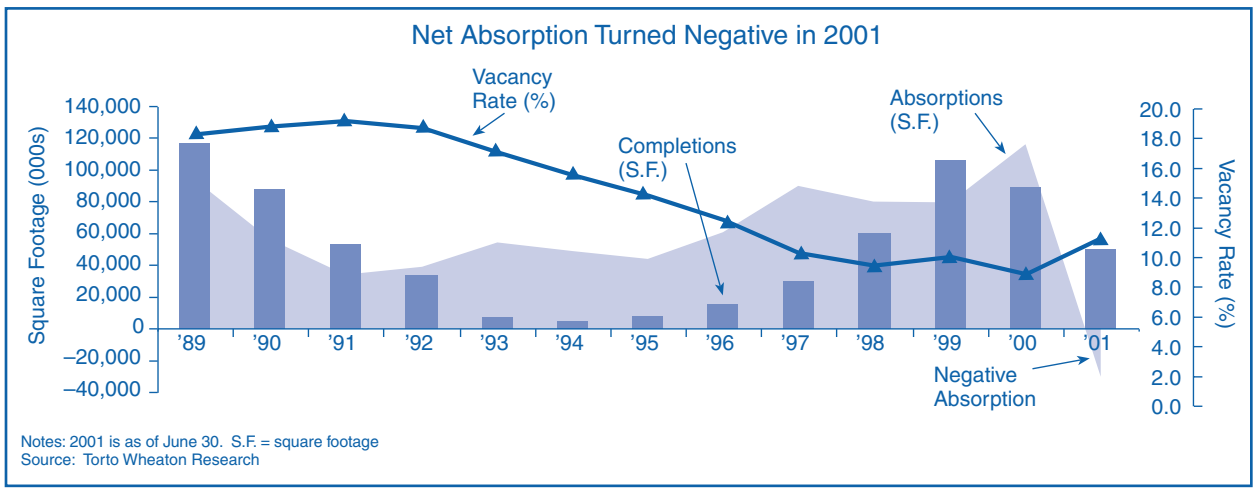
Office employment growth, the source of new office space demand, tends to be driven by the finance and services sectors.[7] Year-over-year job growth in the finance,

[5] Net absorption is the net change in total competitively leased space per period, as measured in square feet.

[6] In some metropolitan areas, over half the total office space available for rent (vacant space) is sublease space.

[7] TWR constructs its office employment index based on trends in the FIRE sector plus selected categories of the services sector. See *TWR Office Outlook,* Spring 2001, Vol. II, p. A.1.

CHART 1



Notes: 2001 is as of June 30. S.F. = square footage
Source: Torto Wheaton Research

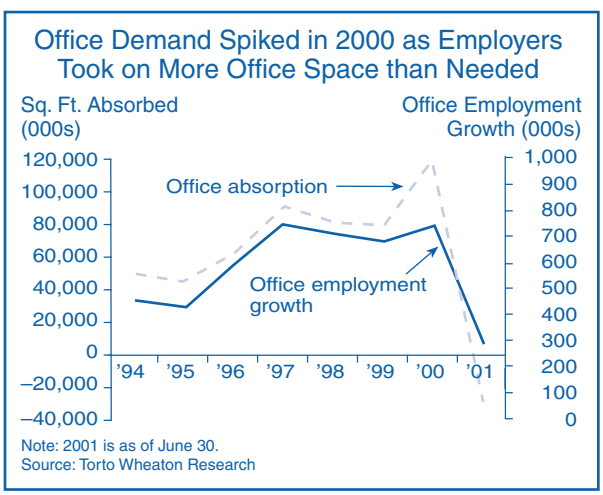
insurance, and real estate (FIRE) and services sectors combined was more than 3 percent in every month from January 1993 through June 2000. Since the middle of 2000, job growth in these sectors has fallen steadily to a year-over-year rate of less than 1.5 percent in June 2001. A spring 2001 survey conducted by ***Salomon Smith Barney*** indicated that tenants estimated their growth in office space demand to be only 0.6 percent over the following 12-month period.[8] Also contributing to reductions in demand are increases in worker layoffs. Announced layoffs during the first seven months of 2001 totaled over 983,000 individuals, more than triple the number of announced layoffs during the same period last year.[9]

The slowdown in the demand for office space contrasts sharply with the situation last year, when absorption rates and office employment growth were robust in most markets, and leases were executed quickly for newly constructed properties. As shown in Chart 2, absorption of office space in 2000 actually outstripped the trend in office employment by a considerable margin. Why? With relatively easy access to initial public offering and venture capital funding, many startup firms anticipated rapid growth and leased office properties accordingly. In fact, venture capital funding facilitated historically higher rates of office space absorption by high-tech and other startups. In active bidding wars, new high-tech firms increased their office space holdings. A phenomenon of *space hoarding* developed in which some high-tech companies leased large quantities of office space in anticipation of future expansion.

More recently, because of a slowing economy, curtailed funding, and failures to achieve sales expectations, many high-tech and dot-com firms have closed or scaled back operations significantly. At the same time, traditional firms have reconsidered plans to expand, adopting a "wait and see" attitude. Consequently, as demand for space declines, large blocks of office space are returning to markets for sublease.

Space available for sublease is similar to landlord-offered space available for rent—space under both categories should count toward a market's available rental space. However, in the case of subleasing, tenants, rather than landlords, offer properties for rent. Tenants may attempt to sublease the property themselves or use a broker; however, in general, only space handled by a broker is included in the tally of a market's available rental space. Consequently, current office vacancy increases could be higher than reported.

CHART 2



Note: 2001 is as of June 30.
Source: Torto Wheaton Research

[8] Boston, Gary, Ross Nussbaum, and Jonathan Litt. May 16, 2001. "Real Estate Demand Survey." *Equity Research: United States, Real Estate Investment Trusts.* Salomon Smith Barney.
[9] Data provided to Haver Analytics by Challenger, Gray & Christmas.

Meanwhile, Construction Continues

An uptick in office construction activity that began in many metro areas during the late 1990s has been a key element contributing to recent increases in office vacancies. According to the ***Bureau of the Census***, U.S. expenditures on office construction totaled $47.5 billion in 2000, continuing a seven-year cycle of expansion. Adjusted for inflation, this amount represents about 78 percent of the peak level of office construction expenditures that occurred in 1985. Recently, the pace of construction has slowed slightly, falling to an annualized rate of $44.3 billion in May 2001.

Reflecting these large dollar outlays on office construction, TWR projected in December 2000 that 111.3 million square feet of new office space (or 3.6 percent of existing stock) would be completed during 2001. This newly completed space will come on the market following a period of rising construction activity from 1998 through 2000, during which the volume of completed office space averaged 84.9 million square feet per year. As shown in Chart 3, however, current office construction activity as a percentage of existing stock falls well below that of the 1980s.

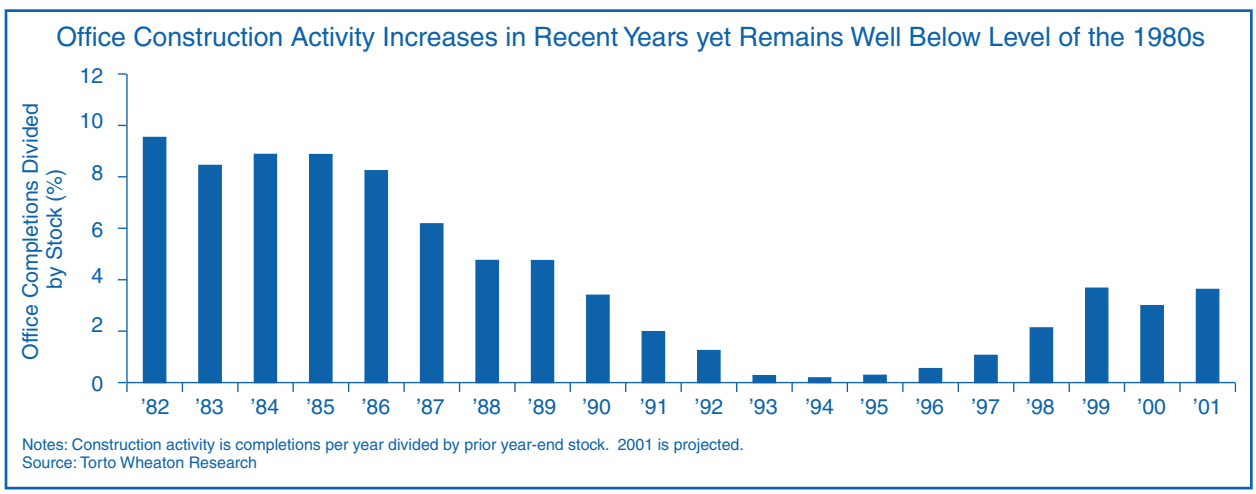
Many metropolitan areas currently experiencing high levels of construction activity also are seeing the largest increases in office vacancies. For example, cities that are positioned toward the upper right quadrant of Chart 4 are characterized by higher vacancy rate increases and more new office space construction. The ten cities with the highest first-half 2001 vacancy rate increases had total square footage of under-construction office space at 6.5 percent of existing stock as of year-end 2000.[10] By comparison, total office space under construction nationally was 4.5 percent of existing stock.[11]

Even as most projects move toward completion, some developers are reconsidering office construction plans. Builders have stopped construction of significant projects midstream in the Austin, Dallas, Seattle, and northern Virginia markets in response to retrenchment by major tenants and competition from subleased space.

Softening Extends to Other Commercial Real Estate

Other major commercial real estate markets are also feeling the effects of a slowing economy and, with the exception of the retail sector, are experiencing increasing vacancy rates.

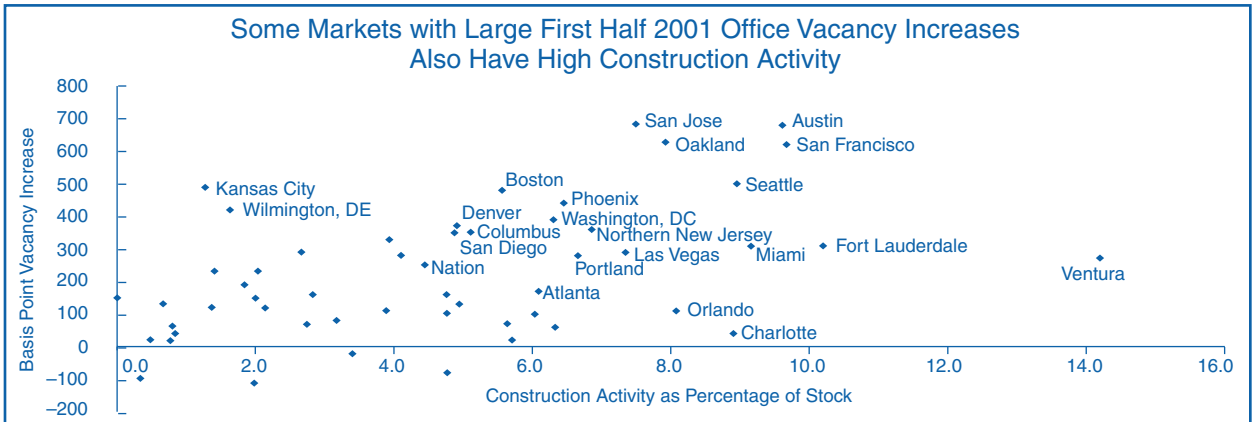
CHART 3



[10] One measure of a metropolitan area's exposure to overbuilding and rising vacancy rates is the degree of construction activity. This measure is found by dividing a metropolitan area's completions square footage or the under-construction square footage by the total stock of office property.

[11] The national 4.5 percent level for office properties *under construction* at December 2000 is higher than the 3.6 percent level for projected *completions* in 2001 because not all properties being built in 2001 will be completed during the year.

CHART 4



Note: Construction activity is measured by a market's under-construction square footage at year-end 2000 divided by total square footage in that market as of year-end 2000.
Source: Torto Wheaton Research, Spring 2001

Industrial vacancy rates had fared well in recent years. As of year-end 2000, the national vacancy rate of 6.7 percent was the lowest since 1984. Now, however, a 150-basis-point increase has occurred, with industrial vacancies increasing to 8.2 percent in the first half of 2001.[12]

As the economy and the nation's high-tech and manufacturing sectors continue to slow, demand for industrial space for research and development and storage and distribution is declining. Industrial property subleasing is on the rise, and negative absorption occurred in the first half of 2001. At the same time, completions of industrial space during 2001 are estimated to exceed 220 million square feet, the highest level since 1988. Landlords are offering concessions, such as lease terms of one year compared with five to ten years, in an attempt to attract new tenants.

Industrial properties are somewhat less exposed to risks from overbuilding than office properties because of shorter construction periods and the ability to respond quickly to any change in demand. An exception is the *telecommunication hotel,*[13] a new entry into this market. This property type is characterized by a longer construction cycle and the fact that it typically has a "single use" design. In recent months, construction of these structures began in many high-tech markets to provide enhanced levels of data service. With declining demand, some telecom hotels stand vacant.

The demand for **hotel** rooms is adversely affected by a slowing economy. Businesses have cut travel budgets and consumers have scaled back leisure plans, contributing to a decline in occupancy levels and revenue per available hotel room in most markets throughout 2001. Currently, upscale and luxury hotels are suffering more than limited service hotels. According to ***Smith Travel Research,*** limited service hotels, particularly budget hotels, represent the only lodging sector with higher occupancy levels through the first four months of 2001 when compared to the same four month period in 2000.

The supply of new hotel properties is lower than in the past, as financing for new hotel construction for the most part has been curtailed in recent years. However, limited service hotels are reported to be overbuilt in a number of markets in the Southeast and Southwest.[14] Annualized expenditures for new construction of all hotel types were $12.1 billion as of May 2001, falling to the lowest level since 1996.[15]

The **multifamily** sector has experienced robust construction and equally strong absorption in recent years as new household formation, the driver for apartment demand, continues to increase. Annualized construction expenditures of $25.5 billion as of May 2001 were at the highest level since 1989.[16] Despite the relative equilibrium between supply and demand for apartments in most markets, vacancy increases and rent declines are occurring in some locations. This decline has been most acute

[12] Torto Wheaton Research.

[13] Telecom hotels are large, high-energy-consuming warehouses that house machinery, servers, routers, and switches that are the physical underpinning of the electronic commerce conducted on the Internet. They are hotels in the sense that they house equipment belonging to many different telecommunication companies. John Holusha, "Home for Machinery of the Internet," *The New York Times,* August 16, 2000.

[14] Kozel, Peter P. June 18, 2001. "U.S. Commercial Property Markets in a Slowing Economy: Implications for CMBS Credit Performance." *Standard and Poor's Structured Finance.*

[15] Data provided to Haver Analytics by U.S. Bureau of the Census.

[16] Ibid.

in the more concentrated high-tech markets, such as San Francisco, where reported average rental rates dropped 8.1 percent between the end of March and the end of May 2001.[17]

Despite a slowing economy, the **retail** sector has performed reasonably well, as consumers maintain relatively high spending levels. Many of the store closings in 2000 and 2001 have been absorbed by new tenants as landlords have acted quickly to avoid letting vacant space linger. Meanwhile, robust construction has continued, with total expenditures in 2000 of $52.6 billion and an annualized level of $52.2 billion as of May 2001. Each of these two years' expenditure levels exceeds all previous years' retail construction amounts since data were first gathered in 1964.[18]

Taking note of the robust level of retail construction activity, a recent ***Moody's*** article finds that the nation's mall retail and "power center"[19] space grew by 3.3 percent in 2000, while population growth expanded by only 1.2 percent. The article raises concerns for potential excess supply of retail space resulting from a construction rate that is almost triple the population growth rate.[20] A negative consequence of the high rate of retail construction is found in a recent ***Standard and Poor's*** study. This article points out that most of the retail mortgages (held in commercial mortgage-backed pools of assets) that defaulted during 2000 did so because of competition from new retail establishments.[21]

Implications for Insured Institutions

Office vacancy rates during the first half of 2001 increased at an unprecedented rate. What does this mean for insured institutions? On the one hand, at mid-2001 vacancy rates remained below their 20-year average. Yet the speed of the increase and the number of metropolitan areas that have experienced softening make this a trend that deserves the close attention of insured institutions, especially those with significant concentrations in commercial real estate and construction lending.

Financial indicators of real estate credit quality in banking remain favorable, with losses and delinquencies trending up modestly from minimal levels. Noncurrent construction and development (C&D) loans as of March 31, 2001, remain at a relatively low .92 percent of all outstanding C&D loans. (Noncurrent C&D loans as a percentage of all C&D loans averaged .93 percent for the past five year-ends.) Similarly, noncurrent CRE loans[22] as of March 31, 2001, were .82 percent of all CRE loans, a level consistent with the average for this ratio of 1.08 percent for the past five year-ends. Charge-off ratios at March 31, 2001, for both C&D and CRE loans were each at .02 percent and remain below the averages of .05 percent for each for the past five year-ends. These favorable numbers are the legacy of a strong economic expansion, whereas current economic events suggest the potential for future deterioration in credit quality.

The outlook for commercial real estate credit quality depends on the depth and duration of the current economic slowdown and on the risk management practices of each institution. In this regard, as signs of increasing risk materialize in conjunction with a declining economy, lenders appear to be managing risks prudently and avoiding speculative lending.[23] Anecdotal information suggests that borrowers are pressed to obtain higher prelease commitment levels in order to gain loan approvals. In addition, lenders are requiring more up-front equity.[24,25]

The importance of risk management practices is magnified by the heightened lending concentrations currently prevailing at some banks. Institutions with elevated concentrations in CRE and C&D lending have been more likely to experience significant problems during times of economic stress (for further details,

[17] Associated Press, News in Brief from the San Francisco Bay Area, June 13, 2001.

[18] Data provided to Haver Analytics by U.S. Bureau of the Census.

[19] According to the Urban Land Institute, a power center is a community shopping center in which at least 75 to 90 percent of the selling space is devoted to multiple off-price anchors and a discount department store or warehouse club. It is the "power" of its anchors that gives the center its name.

[20] Sally Gordon, op. cit.

[21] Kozel, Peter P. April 20, 2001. "Outlook for Property Markets in a Slower-Growing Economy and the Implications for CMBS Credit Performance." *Standard & Poor's Structured Finance.*

[22] CRE loans are nonfarm, nonresidential loans secured by real estate.

[23] Speculative construction lending is defined as a loan not accompanied by a meaningful presale, prelease, or take-out commitment.

[24] "Capital Is Still Plentiful for Right Projects." *Midwest Real Estate News.* July 2001. Vol. 17, No. 7.

[25] Further information on bank underwriting practices can be found in Federal Deposit Insurance Corporation, Division of Research and Statistics, *Report on Underwriting Practices,* http://www.fdic.gov/bank/analytical/report/index.html.

see *History of the Eighties*[26]). As shown in Chart 5, the percentage of insured institutions with commercial real estate loan concentrations between 200 and 400 percent of capital is higher now than it was in the late 1980s. However, there are relatively fewer institutions at the highest concentration level, in excess of 500 percent of capital. In fact, fewer than 1 percent of insured institutions are at this level. A similar story holds true for construction loans, as the increasing concentrations are in the range of 100 to 300 percent of capital (see Chart 6).

There are a number of issues for construction lenders and commercial real estate lenders to consider going forward. Because uncovered loans (C&D loans made without assurances of a firm take-out commitment) tend to be higher-risk, an important part of managing the risk in construction lending has traditionally been the lender's ability to obtain a take-out commitment.

Sources of take-outs for C&D loans include other insured institutions, pension funds, foreign investors, and life insurance companies, along with public-market real estate investment trusts (REITs) and conventional mortgage-backed securities (CMBSs). Anecdotal reports indicate that shifts in market sentiment in recent months have resulted in lowered investments in REITs and consequently less available capital for REITs to purchase real estate.[27] Insured institutions

Chart 5

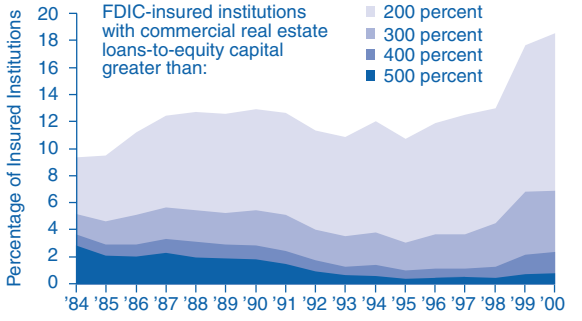
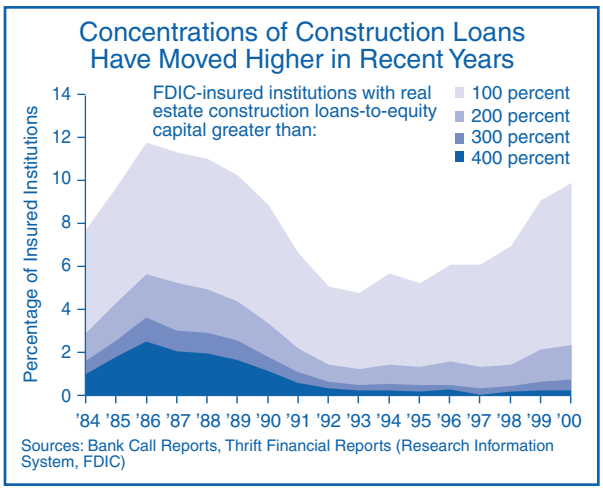


Chart 6



may face increased challenges to convert construction and development loans into permanent loans should the reported REIT situation become a trend and other sources of permanent capital become less available to purchase C&D loans.

Monitoring economic trends in general, and local real estate trends in particular, becomes even more important during a time of rapid change in market conditions. For example, reliance on appraisals based on outdated or top-of-market assumptions can result in a divergence between expected and realized collateral values or cash flows. Similarly, while preleasing commitments offer significant risk-reduction benefits to lenders, during a time of weakening economic conditions there is at least the possibility that a prospective tenant will be unable to honor a lease obligation, as has been the case with some firms in the high-tech sector in recent months.

Conclusion

Office market trends cannot, of course, be considered in isolation. The recent softening in office markets is a symptom of a slowing economy coupled with a rapid decline in the fortunes of some high-tech firms. Considered in this broader context, the challenge for insured institutions is simply to ensure that risk-management strategies are in place that will succeed under a more challenging economic environment.

Thomas A. Murray
Senior Financial Analyst

[26] Federal Deposit Insurance Corporation. *History of the Eighties—Lessons for the Future, Vol. 1: An Examination of the Banking Crises of the 1980s and Early 1990s,* Chapters 9 and 10. 1997. Washington, DC: FDIC. http://www.fdic.gov/bank/historical/history/index.html.

[27] Smith, Ray A. August 1, 2001. "Property Held by Public Firms Drops." *The Wall Street Journal.*

Table 2

Office Market and Banking Data on 53 Metropolitan Areas						
Metropolitan Statistical Area	2nd Quarter 2001 Office Vacancy	Basis Point Increase from Year End 2000	Count of Community Banks with C&D Loans	Median C&D as Percentage of Tier 1 Capital at 3/31/2001 (%)	High-Tech as Percentage of Total Market Employment (%)	Office Space Under Const/ Stock at 12/31/2000 (%)
Albuquerque	11.6	-110	9	61.0	6.8	2.0
Atlanta	9.8	170	76	172.2	3.8	6.1
Austin	11.8	680	20	53.4	10.1	9.6
Baltimore	8.9	60	60	22.8	3.6	6.3
Boston	8.7	480	100	24.1	8.2	5.6
Charlotte	9.0	40	20	48.5	1.7	8.9
Chicago	8.9	130	225	33.5	4.5	4.9
Cincinnati	10.1	100	58	32.6	3.1	6.0
Cleveland	13.6	40	16	34.8	3.0	0.8
Columbus, OH	16.9	350	20	22.4	3.1	5.1
Dallas	16.4	110	75	84.5	6.5	3.9
Denver	12.7	370	45	70.4	5.2	4.9
Detroit	12.0	160	28	35.2	3.1	2.8
Ft. Lauderdale	12.8	310	13	19.1	2.7	10.2
Ft. Worth	16.4	130	36	71.8	3.4	0.7
Fresno	14.4	20	5	196.0	0.9	0.8
Hartford	14.0	150	11	25.2	3.5	0.0
Honolulu	12.6	-190	3	11.4	0.9	0.0
Houston	13.6	60	48	65.8	3.1	0.8
Indianapolis	15.8	120	21	29.6	3.3	1.4
Jacksonville	11.7	-20	11	65.2	1.8	3.4
Kansas City	15.9	490	86	70.8	2.7	1.3
Las Vegas	14.5	290	19	117.7	1.5	7.3
Long Island	10.9	190	6	19.1	5.3	1.8
Los Angeles	14.1	150	62	35.4	3.7	2.0
Miami	10.5	310	26	28.1	1.8	9.2
Minneapolis	10.8	20	119	44.0	6.0	5.7
Nashville	12.8	230	20	78.4	1.2	2.0
New York	5.1	230	34	10.5	2.4	1.4
Northern New Jersey	10.9	360	66	15.0	5.6	6.9
Oakland	9.3	630	12	120.0	6.5	7.9
Oklahoma City	20.3	20	44	57.8	2.6	0.5
Orange County	14.7	330	14	34.5	6.4	3.9
Orlando	13.1	110	23	72.1	2.3	8.1
Philadelphia	10.7	80	68	22.1	4.5	3.2
Phoenix	16.9	440	27	114.2	4.7	6.5
Portland, OR	9.9	280	14	118.8	6.6	6.7
Riverside	14.4	-100	18	143.5	1.6	0.3
Sacramento	6.6	70	11	106.9	3.9	5.6
Salt Lake City	15.3	280	14	111.7	4.5	4.1

Table 2 (continued)

Office Market and Banking Data on 53 Metropolitan Areas						
Metropolitan Statistical Area	2nd Quarter 2001 Office Vacancy	Basis Point Increase from Year-End 2000	Count of Community Banks with C&D Loans	Median C&D as Percentage of Tier 1 Capital at 3/31/2001 (%)	High-Tech as Percentage of Total Market Employment (%)	Office Space Under Const/ Stock at 12/31/2000 (%)
San Diego	9.7	350	21	57.5	6.6	4.9
San Francisco	10.3	620	21	69.0	8.3	9.7
San Jose	8.1	680	5	174.5	27.4	7.5
Seattle	9.4	500	30	77.1	6.6	9.0
St. Louis	10.1	–80	80	40.4	2.6	4.8
Stamford	11.2	290	10	43.5	5.6	2.6
Tampa	14.8	70	33	40.0	4.2	2.7
Tucson	8.8	100	3	178.4	4.4	4.8
Ventura	14.2	270	8	49.7	5.4	14.2
Washington, DC	7.8	390	61	51.1	7.8	6.3
Wilmington, DE	10.4	420	12	28.4	3.8	1.6
W. Palm Beach	12.2	160	18	37.2	2.3	4.8
Westchester	12.5	120	4	19.5	12.3	2.1
Nation	10.8	250	(1) 3,801	(1) 40.1	(2) 4.8	(2) 4.5

Notes: Only community banks with construction loans are included in this table. Community banks are institutions with assets less than $1 billion. Noncommunity banks are excluded because their lending activities are likely to span a larger area than the MSA in which they are headquartered.
Sources: Torto Wheaton Research; Bank and Thrift Call Reports, FDIC Research Information System data; Economy.com, Inc.
1. Only community banks with construction loans and located within a MSA are included in these figures.
2. Percentages shown are the averages for the 53 metropolitan areas.

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